

VZCZCXR06287

RR RUEHAG RUEHDF RUEHIK RUEHLZ RUEHROV

DE RUEHB #4149/01 3491158

ZNR UUUUU ZZH

R 151158Z DEC 06

FM AMEMBASSY BRUSSELS

TO RUEHC/SECSTATE WASHDC 3879

INFO RUEATRS/DEPT OF TREASURY WASHDC

RUCPDOC/USDOC WASHDC

RUCNMEM/EU MEMBER STATES COLLECTIVE

UNCLAS SECTION 01 OF 02 BRUSSELS 004149

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STATE FOR EB/IFD, EUR/ERA AND EUR/UBI
TREASURY FOR OASIA/ICN - Atukorala
USDOC FOR 3133/USFCS/OIO/EUR

E.O. 12958: N/A

TAGS: ECON EFIN ETRD BE

SUBJECT: Money Talks - Economic Factors in Belgium's
Federal-Regional Power Struggle

REF: (A) 04 Brussels 5395 (B) 05 Brussels 4442

(C) Brussels 3952 (D) Brussels 3681

¶1. (SBU) Summary. Belgium's federal-regional negotiations in spring-summer 2007 on the division of political competencies will have major economic implications. If the federal government cedes responsibilities to the regions, regional demands for direct taxing authority and fiscal autonomy will grow. Such demands for autonomy strike a chord in Dutch-speaking Flanders, which many Flemish Belgians believe supports too generously its poorer French-speaking counterpart, Wallonia. Although Walloon nationalists favor more autonomy, economists and the Walloon government emphasize the financial benefits of remaining a federal state. While some politicians actually argue for recentralizing some powers that had been devolved to the regions back to the federal level - arms sales and export controls is a prime example - the history of interregional rivalry portends greater fiscal autonomy for the regions. Economic growth, jobs and investment, and how to get them, are a major focus of regional and federal leaders as they prepare for upcoming negotiations and the federal elections that will precede them. End Summary.

¶2. (U) The Federal-Regional negotiations scheduled to follow the 2007 federal elections will play a determinative role in Belgium's economic future. While overtly a negotiation about furthering the political devolution of power that began with the 1990 Constitution, critical economic issues will be decided as well. Post outlined previously the diverging economies of Belgium's Flemish north and Walloon south, in both industrial character and economic performance (refs A and B). Those differences are having an impact on many political decisions, such as European Space Agency contracts that support Belgium's aerospace industry (ref C).

¶3. (U) The key issue in the negotiations will be the distribution of federal and regional responsibilities. As originally conceived, the division of competencies was based on the most effective and responsive level of implementation: those issues that touched citizens most directly - environment, education, social programs - would be principally overseen by the regions. Overarching national concerns such monetary and fiscal policy, foreign affairs, national defense, employment policy and public health were kept at the federal level. Since 1990 there has been a trend towards granting

greater authority to the regions, to include areas like foreign trade and investment promotion, arms sales and export controls, and technology and investment policy. The Federal government has shifted some programs to diminish its budgetary obligations, and some national politicians have pressed for transfers of powers to regional jurisdictions to demonstrate their regional loyalty.

¶4. (SBU) As the regional role grew, so too grew the battle over economic levers and sources of revenue. At present the federal government wields the power to levy income tax, corporate tax, VAT, and mandatory contributions for social entitlement programs; the regions are limited to inheritance taxes and property taxes. Pressure is mounting in the regions for them to have direct taxing power, rather than depend on federal revenue sharing. In 2005, the Federal budget redistributed 59.8 percent of fiscal revenues to the regions or communities for public administration. Federal authorities face a watershed choice if they agree to further devolution of power, as the center of gravity of economic decisionmaking shifts further out of federal hands.

¶5. (SBU) Yves Leterme, President of Flanders and leader of the center-right CD&V party, has generally been calling for more economic competencies (labor, economy, transportation and justice) to be given to the regions. His views are shared by many, though for different reasons. Flemish conservative parties complain that 8.5 percent of Flemish GDP is sent to support Wallonia each year without thanks or any indication that the Walloons are trying to move away from such dependency. The far right Vlaams Belang party claims Flanders pays 64

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percent of all Belgian taxes ? above their 58 percent of the population. Leading Flemish region politicians complain that the francophone Socialist Party dominates Walloon public administration, leading to corruption and wasted tax monies such as those revealed in recent scandals (ref D). Some Walloon politicians also support greater fiscal autonomy for the regions, but want greater control over money disbursed in the region without severing the ties that grant them significant transfers for so-called economic adjustment. Greater autonomy would improve accountability and facilitate oversight, some claim.

¶6. (SBU) Others in Belgium want to reverse the trend of devolving power to the regions. They question the need for multiplying the administrative burdens and costs that accompany duplication of functions in several regions entails, as well as the effectiveness of regions in providing some services. Generally the VLD (Flemish Liberals) are profiling themselves as defenders of returning money and powers to the Federal Government. After a recent trip to South America, Foreign Minister De Gucht (VLD) openly pleaded for more coordination (if not recentralization) between the several foreign trade promotion services. (Currently Flanders, Brussels and Wallonia each have their own.) Stating that Belgium had to increase its exports to the expanding Asian and developing world markets from 20 to 50 percent, De Gucht was concerned that regional entities could not deliver the trade growth needed. Separately, officials from all three regions have informally remarked to embassy officers that the export control authority devolved to the regions in 2004 requires technical ability and foreign policy guidance that are easier found at the federal level, and saps resources their region would sooner spend for other ends.

¶7. (SBU) The Federal-Regional negotiations also touch on other fiscal interests of the regions. Who

gets aerospace contracts, who sets employment and unemployment policy, whether (federal) corporate taxes should be lowered so that (regional) subsidies to attract and retain companies are no longer needed, how to support R&D and who pays - all these issues are bound up with the power struggle between the regions and the federal government. This is why the recent political dispute over Belgium's contribution to the European Space Agency (ref C) arose: national science policy was seen by one region as overwhelmingly benefiting another region's industries.

¶8. (SBU) Comment: Whereas ?all politics are local,? according to former Speaker of the House Tip O'Neill, in Belgium this is especially true, given the immediacy with which any decision at any political level evokes a response from every Belgian. A continuation of the trend towards regional responsibilities and purse strings is likely at the spring negotiations; the question is whether a threshold will be crossed that so changes Belgians perceptions of their country that it leads to the dissolution of the Belgian federalist state.

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